STATEMENT OF
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A DIVISION OF CHEVRON U.S.A. INC.,
BEFORE THE COMMITTEE ON GOVERNMENT REFORM
SUBCOMMITTEE ON ENERGY AND RESOURCES,
UNITED STATES HOUSE OF REPRESENTATIVES,
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Mr. Chairman and Members of the Subcommittee, on behalf of Chevron I wish to express our appreciation at having the opportunity to appear here today to discuss the Department of the Interior's deepwater royalty relief program.

As Vice President, Deepwater Exploration and Projects, my job responsibilities include looking for new sources of oil and gas in the deepwater Gulf of Mexico. My previous position was General Manager for Deepwater Exploration and Production.

Chevron's Views Regarding the Lack of Thresholds in 1998 and 1999 Leases

As you know, federal oil and gas leases are binding contracts that are not negotiated, but instead (as discussed in more detail below) they are sold at bid in lease sales administered by the Minerals Management Service (MMS). The leases themselves are form documents prepared by the MMS without input from the lessees. Whenever Chevron enters into contractual arrangements with the federal government or any other partner, however, Chevron seeks to honor the terms of the contracts, and Chevron generally expects the same of its counterparties. For this reason, Chevron has always relied on the terms of its federal deepwater leases, including royalty relief where it applies, in evaluating project economics. Of course, the viabilities and risks associated with individual deepwater exploration projects are a function of a complex set of economic, geologic, and other factors. Congress's purpose in passing the Deepwater Royalty Relief Act was to provide incentives for high-risk development of offshore oil and gas resources in frontier areas. Chevron believes that the existing deepwater royalty relief program, including both the statutory regime adopted by Congress in the Deepwater Royalty Relief Act and the current discretionary royalty relief programs administered by the MMS, has worked well in achieving the purposes which Congress intended.

Chevron understands that in the very near future the MMS will be sending letters to Chevron and other companies requesting meetings to discuss the absence of price thresholds in the 1998 and 1999 leases. Chevron has great respect for the MMS as Chevron's lessor and partner in the domestic exploration and production process. If requested, Chevron will meet with MMS to discuss the 1998 and 1999 leases, and Chevron will seriously consider any proposals the agency may offer to resolve the current royalty incentive debate.

Chevron's Participation in Gulf of Mexico Deepwater Leasing Program

Chevron is an active and consistent participant in all aspects of MMS's Gulf of Mexico deepwater leasing program. Chevron expects that MMS will extensively describe the leasing program in its testimony, and also suggests that the Subcommittee may wish to review MMS's report entitled "Leasing Oil and Natural Gas Resources: Outer Continental Shelf" for a thorough overview of the leasing framework. (Available at http://www.mms.gov/ld/PDFs/GreenBook-LeasingDocument.pdf.) As far as Chevron's general level of participation in the program at the program design level is concerned, Chevron submits comments on virtually all aspects of the leasing program where the opportunity to comment is available. For example, Chevron has commented on the proposed 5-year plans for outer continental shelf oil and gas leasing such as the current Draft Proposed Program for Gulf of Mexico leasing for 2007 through 2012. For offshore areas where Chevron is interested in bidding on leases, Chevron has also submitted comments in response to calls for information and nominations regarding proposed lease sales and on proposed notices of lease sales.

Regarding the lease sales themselves, Chevron uses the proposed and final lease sale notices to determine what tracts it will bid on to build its portfolio of lands it would like to explore in keeping with its overall domestic offshore exploration strategy. Using geological and geophysical data, lease terms, and other information regarding the expected utility of offered tracts to the portfolio, Chevron develops a bid for each tract. Chevron then must submit a sealed "bonus" bid at the time of the lease sale. Once bids are submitted, MMS determines the high bids, at which point the high bidders must submit a deposit equal to 20% of their bids. The MMS then evaluates the bids for adequacy based on a variety of factors, including the number of bids submitted and the MMS's assessment of the economic value of the oil and gas resources on each tract as indicated by MMS's extensive geophysical and geological data. MMS often rejects even high bids, which is proper as the Federal Government reserves the right to reject any or all bids or to withdraw any blocks from a sale.

Again, Chevron and other bidders do not have the opportunity to negotiate regarding the terms of their leases. Rather, the MMS prepares the lease along with its addenda and stipulations. Once the MMS deems a high bid acceptable, it notifies the bidder and provides the bidder with a set of official lease forms for execution. After the MMS receives the bid payment and executed lease forms from the successful bidder, the appropriate MMS official executes the lease and returns a duplicate fully executed copy to the bidder. Leases typically become effective on the first day of the month following execution by the appropriate MMS official. Importantly, the failure of a successful bidder to execute and return the lease documents and pay the remaining 80% of the bid amount in a timely fashion results in the lease not being issued and forfeiture of the bidder's 20% deposit.

To provide some idea of the high costs and risks of deepwater exploration, over the last decade Chevron has spent over $3 billion in deepwater Gulf of Mexico exploration investment costs that have resulted in almost no production. At the beginning of this year, Chevron had interests in approximately 750 leases of Gulf of Mexico submerged lands in water depths of 1,000 feet or greater that could be eligible for some category of royalty relief. Chevron paid more than $400 million in bonus bids to acquire its interests in these leases and pays MMS approximately

$40,000 per year per lease in rentals to maintain these leases in its portfolio. Most of the leases will never produce oil or gas. In fact, only 10 of these 750 deepwater leases have produced within the last 5 years. Three of the 10 have already stopped producing, and one is currently shut-in because of damage from Hurricane Rita. Additionally, since the beginning of the year Chevron has relinquished approximately 50 of the 750 leases back to the MMS. As these statistics suggest, more often than not Chevron's exploration activities result in leases being drilled unsuccessfully or not being drilled at all, and being relinquished back to MMS at the end of their terms. In addition to the costs of acquiring and retaining leases that never produce oil or gas, other costs of unsuccessful exploration are also enormous. In 2001 through 2005, for example, in the deepwater Gulf of Mexico alone Chevron incurred approximately $395 million in dry hole costs.

When Chevron does find oil and gas it pays royalties as required by its lease terms, and in 2001 through 2005 Chevron (including Texaco and Unocal) paid the federal government a total of approximately $2.8 billion in oil and gas royalties for production from federal onshore and offshore lands. (This $2.8 billion figure understates the total value of royalties paid by Chevron because it excludes the value of the large volumes of oil and gas delivered to the Government as royalty-in-kind.) In the same 2001 through 2005 time frame, Chevron (including Texaco and Unocal) received an estimated $72 million of royalty relief on properties subject to Deep Water Royalty Relief.

Participation in 1998 and 1999 Lease Sales and Chevron's Manner of Interfacing with MMS and Participation in Rulemakings Implementing the Deepwater Royalty Relief Act

Pre-merger Chevron, Texaco, and Unocal all purchased Gulf of Mexico deepwater leases sold in 1998 and 1999 lease sales. Additionally, the companies routinely commented on MMS rulemakings. As well as participating in various MMS rulemakings through the submission of comments, Chevron personnel routinely attend MMS events, including workshops and training events, and have various business contacts with MMS personnel as representatives of our lessor. Further, MMS personnel are often invited to speak at industry-sponsored training sessions, meetings, and events, such as, for example, Rocky Mountain Mineral Law Foundation seminars and institutes.

Conclusion

Again, on behalf of Chevron I wish to express Chevron's gratitude for being given the opportunity to appear here today to discuss our views on the Department of the Interior's deepwater royalty relief program. I will be happy to answer any questions that you may have.